HollAnd Advisors

Holland Views – Foxtons (Price: 178p, MCap: £507m)

Unstoppable Sales Machine

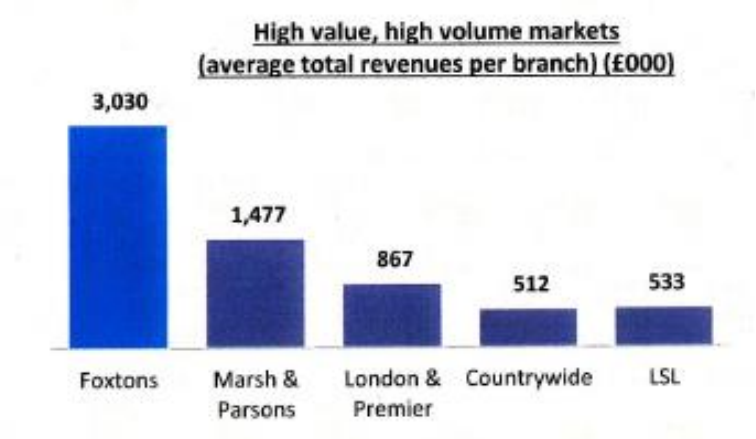
Having recently met Foxtons' CEO at their Chiswick HQ, we revisit our contention of last summer that Foxtons is a good investment 'Franchise'. We remain of that view today and add to it the idea that Foxtons does something very un-British – it prides itself in being a 'sales' organisation and is focused on constantly improving its selling process. Foxtons enjoys an enviable and growing lead over its fragmented estate agency peers and is pursuing a branch rollout and financial model that, we believe, could reward shareholders handsomely in the coming years.

There will inevitably be cyclical risks in such an operationally-geared business and currently elevated London house prices lead us dwell on this point. New Government stamp duty measures muddy the outlook further. Yet another threat is from the new lower-cost online business models (e.g. Purplebricks) who seek to undermine the estate agency status quo. With technology innovation quickly smashing many an old fashioned service sector model these days we think it foolish to dismiss such threats. A look at European and US markets provides some context however.

Plenty of worries, but lots of upside too

In short, there are plenty of uncertainties surrounding the UK estate agency business but we conclude in Foxtons case, that with only 7% national market-share, it has still much to gain from its sleepy high street peers and that there is likely room for both it and the new low-cost pre-paid online challengers to gain share. Normalising profit (EBITDA) per site *back* up to £1m and looking at the likely 2016 number of branches suggests a normalised PE of only 11x. This is far too cheap for the combination of strong growth via rollout, high return on capital and the company's ongoing distribution of excess capital. Let's not forget that these traits, when combined, comprise the characteristics of a 'dream' business.

Fig.1: Foxtons' sales per branch vs the competition says it all



Source: Foxtons, Company Reports

Are we (still) dreaming?

Firstly we very recap on the key conclusions we made in our spring piece "*Holland Views - Are we dreaming – March 2015*". At the time, we suggested that Foxtons:

- *"Enjoys pricing power relative to fragmented and unfocussed competition, due to its better customer experience. Simply put, they are good at selling houses fast…*
- *…Aligned with that, it has built a strong focussed brand and renowned staff culture. Our discussions with competitors suggest that Foxtons is the Maverick in an industry characterised by sleepy franchisees…*
- *…This is also a business with significant operational leverage as seen in the 3% to 33% EBITDA margin expansion in the last cycle (29% in 2014). Rising house prices are of course a tailwind but should not be seen in isolation of the excellent efficiency gains and expansion into lower-priced localities. Well organised military-machine vs. sleeply franchisees…*
- *Returns look very good too with RoNTA at c.100%. This is essentially a people business with a variable cost structure – again the analogy with Goldmans is apt or at a stretch Moody's…" etc. etc. –* **Holland Views – Foxtons, Are We Dreaming – March 2015**

A glut of bad news recently – but don't forget the context

Since that original piece in March 2015 (at 195p) much has happened:

- Housing transaction volumes slowed ahead of the election due to uncertainty.
- The Conservatives then won an outright majority at the election (upon which Foxtons stock was up 12% in a day).
- But, the London housing market transactions did not recover as fast as expected and more recently, the top end of that market looks to be cooling.
- In November the Chancellor adds a new 3% Buy-to-Let stamp duty surcharge on top of the new regime introduced last autumn.
- More and more online 'discount' estate agent sites are launching (and floating) which could put downward pressure on the commission of mainstream estate agents.

We do not dismiss any of these potential risks but for now just add the following new information we have learnt from the company to put these threats or changes into some context:

1. The group has previously shown data observing that the vast majority of their sales *by volume* are not affected by the first stamp duty changes made by the Chancellor (Nov 2014). See Appendix – Figure 3.

   The following is perhaps more useful context to that point:

   - 6-8% of the group's sales revenues are of properties priced above £2m. We note that for a £3m property, stamp duty has, since November 2014, risen from 7.0% to 9.1%.
   - However a larger 23% of Foxtons sales revenues are of homes priced between £1m-£2m. We also note that at a £1.5m selling price stamp duty was 5.0% pre-Nov 2014, it is now 6.3%.
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